Earned Income Credit and the Work Incentive

By Steven Pearlstein
Washington Post Staff Writer

Since the inception of the earned income tax credit, conservative critics have complained that it discourages both work and marriage.

For workers with two children, for example, every dollar earned between $11,000 and $25,000 this year has the effect of reducing the total EITC payment by 18 cents. This amounts to an 18 percent surtax on wages, and various studies estimate that the 8 million workers in this phaseout range are likely to reduce their work modestly because of it—on average, somewhere between 10 and 89 hours per year.

At the same time, however, the EITC offers strong work incentives for the genuinely poor—welfare mothers and adults who earn less than $9,000 a year—by supplementing every dollar they earn with an extra 30 cents from the Treasury. Among this smaller group of 3 million, studies show, the EITC induces people to work an extra 38 hours each year on average.

Taking both groups together, University of Wisconsin economist John Karl Scholz calculates that the EITC, on balance, induces slightly more work than it discourages.

Like other critics of the EITC, Marvin Kosters of the American Enterprise Institute argues that the program's incentive to work could be strengthened if the size of the earned income credit were reduced and benefits phased out at lower income levels.

But Gary Burtless, a Brookings Institution labor economist, maintains that although any government welfare program is bound to lower work effort to some extent, the earned income credit does so much less than others.

"The surprising thing about the EITC is that it can pump $25 billion into the pockets of the working poor each year and not discourage work effort more than it does," said Burtless.

Critics also point out that the EITC's benefit structure imposes a huge financial penalty to marriage—a loss of $5,700 in cash payments in the worst-case scenario of two minimum-wage workers with children who decide to marry.

But in other cases—a minimum-wage worker who marries a welfare mother with children—the EITC actually increases their post-marriage income by $3,370.

"My suspicion is that more taxpayers have an incentive to marry than separate because of the EITC," economist Scholz recently told a Senate panel, "but I know of no empirical evidence . . . that suggests people manipulate their legal living arrangements to respond to these incentives."

7-30-95
WPost